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# The Liscio Report

On the Economy

For John Liscio 1949-2000

## Incomes (& Fed policies?) take a beating

In August, 48% of the states in our survey met or exceeded their forecasted sales tax collections, up a tad from July's 45%, and 88% reported growth over the year, up from 67% in July. The average over-the-year rate of change was flat with July's 3.5%, and the margin from forecast fell to -1.4%, from July's 0%.

The percentage of contacts whose comments indicate growing concern about future revenues has risen to 60%, while those who are confident about the future is holding at about one third. About one-tenth are genuinely worried, and expect revenues to slip in coming months. Three-quarters of our contacts expressing confidence about future growth are in states with heavy energy extraction centers, with the remainder in the Midatlantic and Midwest. Of those who are expressing growing concern, just less than half are housing-bust states that have seen revenues slow recently, about a third are in heavy manufacturing states, with the remainder scattered around the country, but are states that were identified by the BLS as having large investment banking centers. Sixty-percent of those genuinely worried are in, again, housing-bust states, with the remainder split between the Midatlantic and the manufacturing Midwest.

- ***sales tax survey softening***
- ***incomes down, poverty flat despite recovery***
- ***the bite of health care costs***
- ***you have to reach to the 80th percentile to find decent wage growth***
- ***QE ineffective, fiscal policy thought unthinkable: what are we to do?***

A few of our state contacts noted that their data support the idea that people are still in the process of replacing goods, perhaps especially durable goods, but are not confident how long that will last.

In addition to the Woodford paper presented at Jackson Hole we mentioned last week, a number of former Fed officials and related academics have recently released papers sounding the alarm on current monetary policy. Rather than focussing on inflation fears (which are understandable although inflation generally is not a problem following financial crises), these papers

*fidarsi é bene; non fidarsi é meglio*

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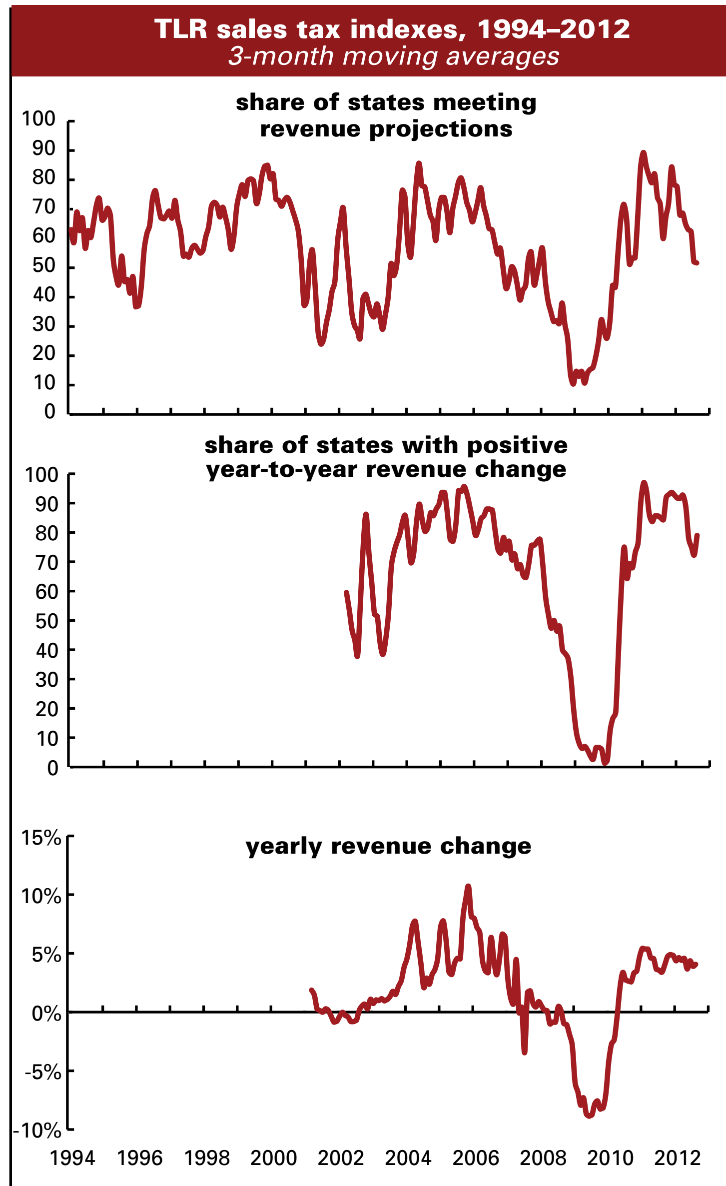
question quantitative easing's ability to make a dent in the unemployment rate, for too long at an unacceptably high level, note that the Fed may have fewer options than it suggests, and that concerns about deficits have taken fiscal policy out of the mix, leaving us to try to solve problems using monetary policy that have traditionally been fought on the fiscal front—our big experiment. And the Fed itself, with its eye on another round of QE, is helping to pull the rope.




Although only a handful of our contacts are thinking about downgrading forecasts any time soon, the tenor of our survey is softening, so it's not just monetary specialists sounding the alarm. In revenue departments around the country, all eyes are on September, a big month for receipts and safely past the beginning of the fiscal year.

**what recovery?**

Wednesday brought the release of the annual income, poverty, and health insurance numbers from the Census Bureau. They showed median household income down 1.5% in 2011, and a remarkable 8.1% below the 2007 pre-recession peak. That's the worst four-year performance since the household numbers began in 1967, and half again as large as the previous record, set from 1989–1993. Income inequality, as measured by the Gini coefficient, rose by 1.6%, also setting a record. The poverty rate fell from 15.1% to 15.0%, not statistically significant, roughly matching highs set in 1983 and 1993. The share of the population without health insurance fell from 16.3% in 2010 to 15.7% in 2011—but the decline was entirely the result of a rise in the share insured by Medicaid. The share covered by private insurance of any kind and by employer-based health insurance both declined.

The persistent declines in income have taken their toll on the public mood. A survey released the other day by the Pew Center reports that almost a third of



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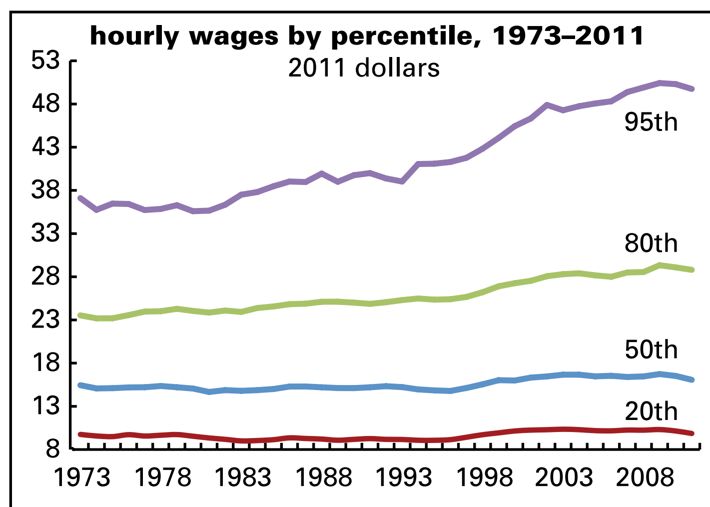
Americans, 32%, now identify as in the lower classes, up from 25% in 2008. This broad category is a combination of those identifying as "lower class," now 7% of respondents, and "lower-middle," 25% of respondents, but the 32% combined total now dwarfs the "upper" category, which comes in at 17% (15% upper-middle plus 2% upper). Four years ago, the broad "upper" total was 21%, not far behind the lower category. The middle shrank from 53% to 49%.




In a departure from the past, whites are just as likely to self-identify as being in the lower ranks as blacks. In 2008, blacks were half again as likely to classify themselves in the broad "lower" category. There was also a sharp increase in the number of college grads calling themselves lower. The youngest cohort, 18–29, was not only the one self-reporting the largest share in the lower ranks, 39%, but it also showed the sharpest increase. The oldest cohort, 65 and over, had the lowest share, 20%, virtually unchanged from 2008.

Clearly, the Great Recession and the weak recovery have taken a toll not only on income and employment (bad enough), but on self-image—a development that will have profound economic and political effects on a society that has historically thought of itself as almost universally middle class. Members of the lower class report being significantly less happy and more prone to sickness and personal crises than those above them. And the generational gap—with twice as many young people as old falling into the lower class—is likely to intensify distributional fights. This is not good news.

### health insurance

Speaking of health insurance, the Kaiser Foundation just released their annual study on workplace provided kind this week. In 2012 employer contributions for family coverage rose 4%, to $15,745, and 3% for single coverage, to $5,615. Annual worker contributions rose 4.5% for families and 3.3% for singles, and are now up 32% for family and 37% for single coverage over the last five years, and 180% and 200% since 1999.

The overall percentage of firms offering health benefits is stable over the last two years (60% and 61%) but down from 2000's 68% and 2010's 69%. Over that period, coverage by large firms has been about level, but at 61%, coverage by small firms has now fallen from a high of 68% set in 2000 (and touched in 2010).

Coverage is heavily weighted toward upper wage earners. Sixty-eight percent of firms where fewer than 35% of the workers make $24,000 or less provide coverage, while only 28% of firms where more than 35% of workers earn $24,000 or less provide coverage. Firms where 35%+ workers make over $55,000 have the highest coverage rate (77% by this metric), ahead

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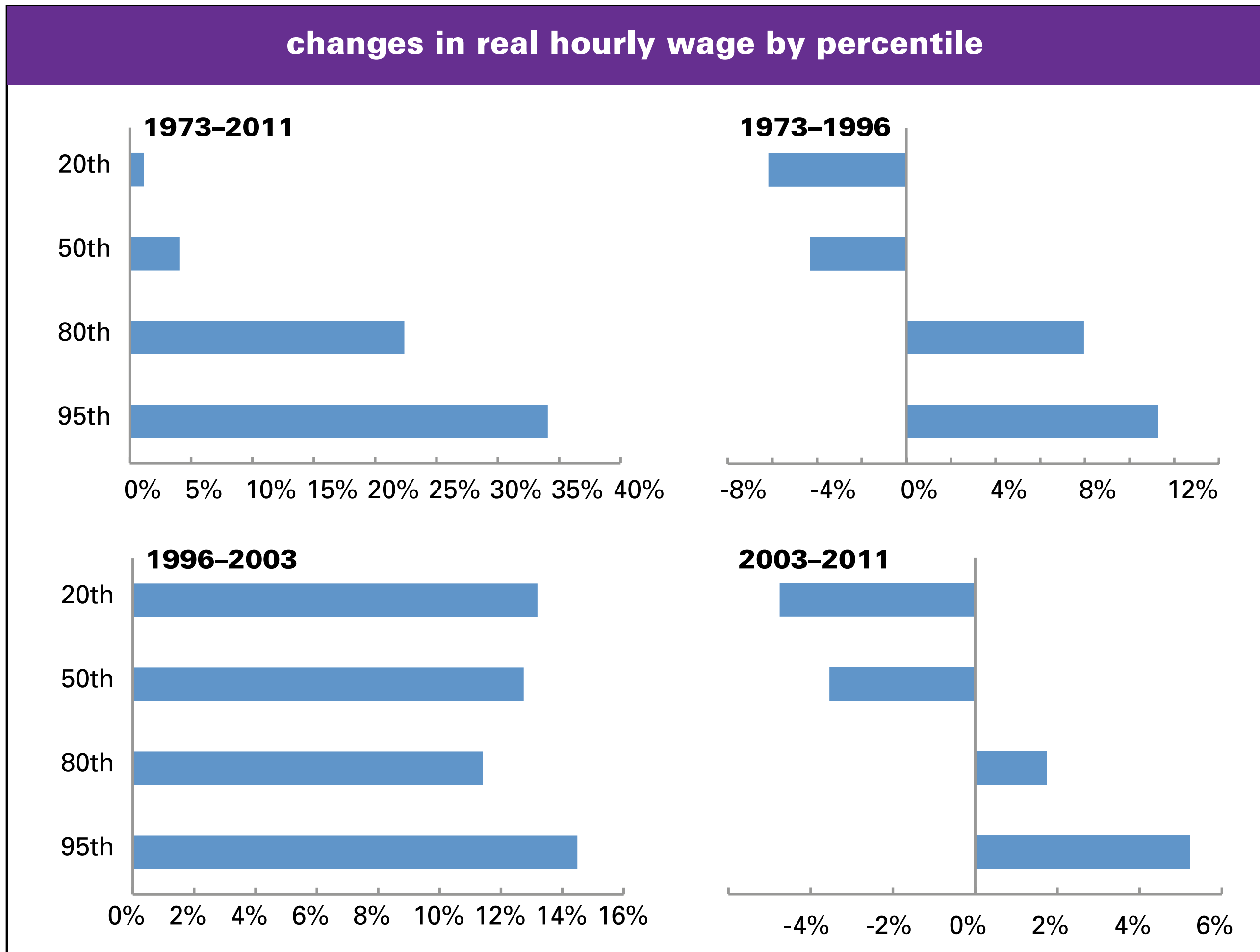
of the 68% at firms with at least some union members. Firms with 35% or more workers under age 26 have the lowest coverage rate (26%), about half the rate of firms where 35%+ are over 50.

Although annual premiums are lower for firms with at least 35% of workers making $24,000 or less, employees pay a higher percentage of the premium at these firms.

Health insurance inflation continues to outstrip growth in earnings, and with the share contributed by employees themselves on the rise, it is another obstacle to spending as well as a source of pain. (More on the health care bite below.)




**wage distributions**

For most people, household incomes are a function of wage and salary income; income from savings and businesses are negligible below the 80th or 90th percentile. In the latest edition of its biennial *State of Working America*, the Economic Policy Institute uses data from the Current Population Survey to chart the changes in income at various percentiles in the distribution. (Highlights are graphed above.)

Wage growth since 1973 has been barely positive at the median and below—just 4.0% over the last 38 years at the 50th percentile, and 1.1% at the 20th. What growth



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there was happened almost entirely during the 1996–2003 period. Since 2003, wages are down 3.5% at the median, and 4.8% at the 20th percentile. You have to go up to the 80th percentile to find any wage growth since 2003, and even there it's just 1.7%.

What's responsible for the weakness in broad wages? Hard to say for sure, but we know that it's not a productivity problem. According to EPI's calculations, real GDP per hour worked is up 80% since 1973, and 23% since 2000—but the median real hourly wage is up only 11% and 4% over those time periods, respectively. The median hourly wage was 54% of GDP per hour worked in 1973, and 33% last year.

A popular explanation for increasing wage inequality, higher returns to education and skill, is also hard to justify in recent data, though it fits earlier patterns. The so-called college premium, the ratio of the average college grad's hourly wage to that of a high school grad, was 145% in the early 1970s. It rose to 175% in 2000, but has been pretty flat ever since. And the premium for an advance degree over a mere bachelor's has also been flat over the last decade. The average real hourly wage for the holder of an advanced degree was up just 2.8% between 2000 and 2011.

EPI also presents some disturbing calculations on household income growth since 1979. For the middle fifth, real incomes at first glance appear to have risen 19.1%, according to familiar Congressional Budget Office figures. But they deflate health benefits by the standard CPI, not the far more inflationary medical care component. Deflate them with that index, and household incomes rose just 12.7%. Take away government transfers, like Social Security and Medicare, and it's down to 5.9%. For the middle ranks, private-sector incomes have barely grown for more than 30 years.

**the ongoing jobs crisis**

It's not hard to explain the miserable performance in wage income for the bottom 80% of the population since 2003: an extremely weak job market during the 2002–2007 expansion, a savage recession in 2008 and 2009, and a weak recovery ever since. The continuing stickiness in unemployment (including mass labor force withdrawal) and the skew of new jobs toward low-paid occupations is producing serious levels of material distress for large swathes of the population.

The stagnation in mass wages was masked for the first few decades by vigorous growth in credit. Now that households are deleveraging—we'll see in a few weeks with the release of the second quarter flow of funds stats if the trend has continued—the kick of borrowed money is gone, and it shows. (One wonders how much of the souring mood uncovered by the Pew survey was produced by the closing of the credit window to many households; the income trends have been in place for several decades.)

We understand that the Federal Reserve, in contemplating something like QE3, is

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responding in no small part to the gloomy jobs and income picture. But we share the doubts detailed in the papers noted above about the efficacy of another round of extraordinary monetary action; each intervention has seemed less powerful than the last. The mechanism for transmitting the QE stimulus into the real economy just isn't at all clear, and it's not well documented by experience either. It doesn't lead people to buy houses, cars, or chin lifts, nor can it pay the college tuition bill.

So we're back in the lab. Aggressive fiscal policy, politically unthinkable at the moment, and made financially difficult by Moody's threat of another downgrade, is probably off the table. Nevertheless, although we are actually doing better than the average following a financial crisis on the employment front, it's hard to imagine how we can take another several years of this deflationary grind, whether economically, politically, or socially.

**Friday's retail numbers**

And through all of this Americans, somehow, continue to spend—though there's certainly been a slowdown in trend retail growth over the last several months.

The percentage of states reporting growth in sales tax revenue over the year rose in August, and the ICSC chain-store report was surprisingly strong. After correcting for various anomalies, ICSC reports yearly sales were up 5.7%, not the 2.6% official but raw number in their report, and monthly sales were up 1.5%, after a 0.3% increase in July.

August results were stimulated by heavy promotions, ranging from free haircuts at JC Penny to free iPads at Abercrombie & Fitch and, according to the BEA, retail price indexes have been sliding over the last several months: a winning combination. Also, back-to-school shopping tends to be heavy on clothing, much of which is below the taxable threshold, suggesting that sales could have been stronger than our survey indicates.

We expect the August Advance Retail Sales report to come in at +0.8% headline, and +0.9% stripping out autos. We suspect two months of relative strength are more likely catch-up from those three negative prints than the start of a new trend, and although the smoothed news continues to be weak, it's nice to have gotten past the recessionary signal coming from consecutive months of decline in retail spending.

—Philippa Dunne & Doug Henwood


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